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FISCAL IMPACT STATEMENT

LS 6910 **NOTE PREPARED:** Feb 24, 2006
BILL NUMBER: SB 345 **BILL AMENDED:** Feb 23, 2006

SUBJECT: Taxation and Government Finance.

FIRST AUTHOR: Sen. Meeks **BILL STATUS:** CR Adopted - 2nd House
FIRST SPONSOR: Rep. Espich

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *Trending Delay:* The bill delays the start date for application of annual adjustments to assessed values until the 2007 assessment date (current law requires these adjustments to begin on the 2006 assessment date).

Corporate AGI Tax Add Back: The bill requires corporations, except Indiana insurance companies subject to taxation under Section 831 of the Internal Revenue Code and Indiana life insurance companies under certain circumstances to add back to state Adjusted Gross Income Deductions taken on the corporation's federal income tax return for the corporation's intangibles expenses and directly related intangible interest expenses.

Payment Delay: The bill requires the reversal of part of the payment delays in the schedule under which: (1) Property Tax Replacement Credit and Homestead Credit amounts are distributed to taxing units; and (2) distributions to state educational institutions are made.

Tuition Support: The bill increases the 2006 calendar year cap on state tuition support distributions by $48,200,000. It increases the state fiscal year appropriation for state tuition support distributions for the state fiscal year beginning July 1, 2005, and ending June 30, 2006, by the greater of: (1) $20,100,000; or (2) the amount needed to enable the department of education to make tuition support distributions without reducing the amount of any school corporation's distributions made before July 1, 2006.

Child Welfare Relief Tax Credit: The bill provides an additional child welfare relief credit in 2006 against property tax liability imposed on a homestead.

It makes an appropriation.

Effective Date: (Amended) Upon Passage; July 1, 2005 (retroactive); January 1, 2006 (retroactive); March 1, 2006 (retroactive); July 1, 2006; January 1, 2007.

Explanation of State Expenditures: *Background - Original PTRF Payment Delay*: Under current law, the state currently makes six PTRC/HSC distributions to counties each calendar year from the Property Tax Replacement Fund (PTRF). Under HEA 1001-2001, the May 2001 distribution was delayed until July 2001. Under HEA 1001-2002(ss), the May-July delay was extended to all years beginning in CY 2002. The payment that was moved is equal to 16.6% of the total annual payment.

The FY 2002 appropriation for higher education was reduced by 1/12. Since universities operate on a fiscal year budget, instead of a calendar year budget like other units of local government, this was a reduction in revenue for universities' FY 2002 budgets.

Background - 2005 Budget Bill Action regarding PTRF Payment Delay: The current budget bill, P.L. 246-2005, requires the State Budget Agency to repay up to ½ of the payments delays during the FY 2006-FY 2007 biennium if there are sufficient funds available. An early distribution of 50% of the PTRC/HSC payment delay balance will equal about $184 M. However, the Budget Agency may reduce the percentage that is to be repaid if there are insufficient balances to fund repayments of 50%. No additional payments have been made to date.

(Revised) *PTRF Provisions Summary*: This bill speeds up the statutory PTRC/HSC payment schedule and makes additional appropriations to institutions of higher education. This bill appropriates $15 M in FY 2007 for additional distributions of PTRC/HSC, and $15 M in FY 2007 for general repair or repair and rehabilitation of dormitories or other student housing of state educational institutions, for a total appropriation of $30 M in FY 2007.

(Revised) *PTRC/HSC:* Beginning in CY 2007, the bill would change the PTRC/HSC distribution amounts for May and July. A new May payment will equal 0.68% of the total calendar year expenditure, and the July payment would be reduced from 16.6% to 15.92%. This provision would shift 0.68% of the total CY 2007 distribution from FY 2008 to FY 2007. This schedule would continue for future years. The new May, 2007, distribution is estimated at $13.8 M under this provision.

The amount of the PTRC/HSC payment delay (from FY 2007 to FY 2008) is estimated at about $336.7 M under current law. The revised distribution schedule in this bill *along with* the current PTRC cap would reduce the amount of the FY 2007 - FY 2008 PTRC/HSC delay to an estimated $322.9 M.

(Revised) *Higher Education:* The bill also appropriates $15 M to universities for general repair and replacement. The payment of the $15 M is to reduce any claim that universities have due to the payment delay in FY 2002. The total cost estimate to reverse the payment delay to universities is about $112.8 M. After the initial $15 M distribution under this bill, the remaining cost of eliminating the higher education payment delay could be as much as $97.8 M.

Tuition Support: In FY 2006, the bill appropriates the greater of $20.1M or an amount sufficient for the Department of Education to fund the school formula without making any reduction in the tuition support for the first six months of CY 2006.

(Revised) *Trending Delay:* Under current law, annual adjustments to real property AVs (commonly referred to as "trending") will be effective with taxes payable in 2007. The DLGF has adopted a rule establishing a system for annually adjusting the AV of real property to account for changes in value in those years since a general reassessment of property last took effect. This bill would delay the implementation of trending by one year until taxes payable in 2008.

The varying rates at which assessed values in each class of property grow in relation to each other determine each class's relative share of the tax burden. Generally, the trending adjustments will shift part of the tax burden from personal property to real property. There will also be shifts between the different classes of real property. Subject to appropriation, these shifts will result in an increase in the state's liability for PTRC and homestead credits (HSC) under current law.

The current state budget, HEA 1001 (2005), appropriated $2,028.5 M for each year of the FY 2006/FY 2007 biennium to pay PTRC/HSC expenses. If the PTRC and homestead credit rates generate a liability in a year that is greater than the appropriation, then the PTRF Board must proportionately reduce the 60% school general fund, 20% regular PTRC, and 20% homestead credit percentages.

It is estimated that under current law, with the trending adjustments taking effect for taxes payable in CY 2007, the state's full liability for PTRC/HSC would cause FY 2007 expenditures to exceed the appropriation by about $55.9 M. The excess liability will require the DLGF to reduce the credit percentages for all of CY 2007, not just the part of CY 2007 that falls within FY 2007. The total CY 2007 PTRC/HSC reduction is currently estimated at $167.3 M. The one-year trending delay in this bill would cause the state's full PTRC/HSC liability and the CY 2007 reduction amount to be smaller.

The trending delay provision, in conjunction with the speedup of PTRC/HSC payments would reduce the amount by which the full payment in FY 2007 would exceed the appropriation from $55.9 M down to $38.8 M. The estimated total CY 2007 PTRC/HSC reduction under this provision would change from $167.3 M to $113.8 M. Actual State expenditures would be unchanged by this provision.

(Revised) *Child Welfare Relief Tax Credit:* Under this bill, the state would pay a child welfare credit to homeowners in CY 2006. The credit would equal an additional 12% of homestead credit for all homesteads, statewide. The estimated cost of the credit is $147.4 M in CY 2006, or $49.2 M in FY 2006 and $98.2 M in FY 2007.

The bill would allow county auditors to apply the entire credit to the November 2006 tax installment if payment of half of the credit against the May 2006 installment would delay tax bill mailings. Depending on the timing of the credit payments locally, all of the credit could be paid by the state in FY 2007.

The bill provides for a distribution from the Property Tax Replacement Fund (PTRF) to pay for the credit. This distribution would not be subject to the current PTRF appropriation limits that apply to the existing homestead credit and PTRC. The PTRF is supplemented by the state General Fund, so this credit would ultimately be paid from the General Fund.

Explanation of State Revenues: (Revised) *Corporate AGI Tax Add Back:* The bill establishes an add back of deductions taken on a corporation's federal income tax return for intangible expenses or certain intangible interest expenses paid, accrued, or incurred by the corporation with one or more members of the same "affiliated group" of corporations or with one or more foreign corporations. The amount of revenue that could potentially be captured due to the add back is indeterminable and dependent on the number of corporate taxpayers currently conducting these types of transactions with affiliated group members. It is important to note that the magnitude of the fiscal impact also depends on the extent that these taxpayers can establish that they meet criteria (also specified in the bill) that precludes the add back from applying to them. Since the add back is effective for taxable years beginning after June 30, 2006, any fiscal impact could commence in FY 2007.

Under the bill an "affiliated group" is one or more corporations connected through stock ownership with a common parent corporation provided that: (1) the common parent directly owns stock of at least one of the group members comprising at least 50% of the voting power and 50% of the value of that group member; and (2) stock meeting the 50% test in each member other than the common parent must be owned directly by one or more of the other members.

Background: A common example of a related member transaction involves the use of a passive investment company (PIC) to transfer income to a tax haven state that is actually income earned and taxable in Indiana. An Indiana operating company can establish a PIC in a state that does not have a corporate income tax (like Nevada) or that has a special income tax exemption for intangibles (like Delaware). Once the company establishes a PIC in another state, the company can then transfer income ("profits") to the PIC by having the PIC charge a royalty fee to the Indiana company for the use of a trademark, patent, or other type of intangible asset. This reduces the Indiana AGI tax liability of the operating company.

These transactions are further complicated when a PIC loans "profits" back to the operating company, and the operating company can then deduct the loan interest from Indiana AGI, thereby reducing their tax liability. Typically, large multi-state retailers engage in these sorts of transactions. Companies are not required to include payments for intangibles in Indiana Adjusted Gross Income if the company has a location in another country with a comprehensive income tax treaty with the United States.

Explanation of Local Expenditures: (Revised) *Trending Delay:* The cost of local homestead credits would be affected by the trending delay. Ten Indiana counties provide local homestead credits funded with proceeds from the County Option Income Tax (COIT) and thirty-four counties provide local homestead credits funded with proceeds from the County Economic Development Income Tax (CEDIT). Thirty-three of the thirty-four CEDIT-funded homestead credits are tied to mitigation of the shift from the 100% inventory deduction. The cost of the local homestead credits will increase under trending. The trending delay under this proposal would result in local homestead credit savings in CY 2007. The amount spent on COIT-funded homestead credits reduces the amount COIT available for distribution to the civil taxing units in the county. So, the savings would be distributed to local civil units. The CEDIT income tax rate designated for homestead credits would not have to be as high under the bill as they would under current law. The revenue raised for CEDIT-funded homestead credits may not be used for another purpose.

Explanation of Local Revenues: *PTRF Payment Delay:* Total local unit revenue for a calendar year would remain unchanged. Some state credit payments would be received earlier in the calendar year under this provision than under current law.

(Revised) *Tuition Support:* The bill increases the maximum tuition support distribution for CY 2006 to school to the greater of $3,802,900,000 or the amount sufficient such that the Department of Education would not be required to may a reduction in tuition support in the last six months of CY 2006.

(Revised) *Trending Delay:* The tax shifts from personal property to real property and the shifts between and within property classes that will occur as a result of trending would be delayed by one year if the implementation of trending is delayed by a year.

(Revised) *Child Welfare Relief Tax Credit:* Homestead net taxes would be reduced in CY 2006 by the amount of the credit. Total local revenues would not be affected by this provision.

State Agencies Affected: Commission for Higher Education; State Auditor; Department of Local Government Finance; State Universities; State Budget Agency; Department of Revenue.

Local Agencies Affected: Counties.

Information Sources:

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